

75-1916

Supreme Court, U. S.
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IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1975

No.

JACK BALLARD,
Petitioner,

vs.

UNITED STATES OF AMERICA.

PETITION FOR A WRIT OF CERTIORARI

To the United States Court of Appeals
for the Eighth Circuit

IRL B. BARIS
KENNETH H. GRAEBER
721 Olive Street
St. Louis, Missouri 63101
Attorneys for Petitioner



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Jack Ballard, your petitioner, respectfully prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered in the above entitled cause on April 28, 1976, in which the conviction of petitioner on Count I was affirmed.

OPINIONS BELOW

This cause was decided by a panel of the United States Court of Appeals for the Eighth Circuit on April 28, 1976, in an opinion which has not yet been officially reported. The opinion is reproduced as Appendix A hereto.

On June 7, 1976, the Court of Appeals denied petitioner's petition for rehearing and suggestion of appropriateness of rehearing in banc. (See Appendix C.) No opinion was written, and the order has not been officially reported.

JURISDICTION

The judgment of the United States Court of Appeals was entered on April 28, 1976. (See Appendix B.) A timely petition for rehearing with suggestion of appropriateness of rehearing in banc was denied on June 2, 1976. (See Appendix C.)

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

Whether the conviction of petitioner for filing a false income tax return in violation of 26 U.S.C. § 7206(1) resulted from improper application of the revenue laws of the United States, including:

1. Whether Schedule C to Form 1040 must be filed if the taxpayer sustains a loss in his business which he does not intend to deduct from his other reported income.
2. If Schedule C must be filed under such circumstances, whether the failure to file it is a violation of 26 U.S.C. § 7206(1), or whether a lesser included offense instruction under 26 U.S.C. § 7203 (failure to file or supply information) should have been given.
3. Whether the prosecution sustained its burden of proving a violation of 26 U.S.C. § 7206(1) under an indictment charg-

ing that petitioner filed a false return by failing to report "substantial income," whereas the proof related only to gross receipts without proof of expenses, thereby resulting in a variance between the indictment for income and the proof of receipts.

4. Whether the prosecution had the burden of proving and accounting for expenses, and whether petitioner was improperly restricted in his efforts to prove such expenses.

5. Whether the Court of Appeals properly applied Treasury Regulation § 1.61-3 so as to permit or require evidence of expenses only with reference to a limited portion of petitioner's businesses, and whether the Court of Appeals properly applied the plain error doctrine to the facts of this case.

STATUTES AND REGULATION INVOLVED

Statutes of the United States

Title 26, United States Code

§ 7203 Willful failure to file return, supply information, or pay tax.

Any person required under this title to pay any estimated tax or tax, or required by this title or by regulations made under authority thereof to make a return (other than a return required under authority of section 6015), keep any records, or supply any information, who willfully fails to pay such estimated tax or tax, make such return, keep such records, or supply such information, at the time or times required by law or regulations, shall, in addition to other penalties provided by law, be guilty of a misdemeanor and, upon conviction thereof, shall be fined not more than \$10,000, or imprisoned not more than 1 year, or both, together with the costs of prosecution.

§ 7206. Fraud and false statements.

Any person who—

(1) **Declaration under penalties of perjury.**—Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a written declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; . . . shall be guilty of a felony and, upon conviction thereof, shall be fined not more than \$5,000, or imprisoned not more than 3 years, or both, together with the costs of prosecution.

Treasury Regulation (1971)

§ 1.61-3 Gross income derived from business.

(a) **In general.** In a manufacturing, merchandising, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources. Gross income is determined without subtraction of depletion allowances based on a percentage of income, and without subtraction of selling expenses, losses, or other items not ordinarily used in computing cost of goods sold. The cost of goods sold should be determined in accordance with the method of accounting consistently used by the taxpayer.

STATEMENT

Petitioner was convicted on both counts of a two-count indictment (R. 1-2)¹ charging him with violations of § 7206(1)

¹ "R." refers to the Record on Appeal and "Tr." refers to the three-volume transcript of trial proceedings filed in the Court of Appeals. The Record and Transcript are being certified to this Court at the request of petitioner.

of Title 26, United States Code, in that he "did willfully and knowingly make and subscribe a United States Individual Income Tax Return, Form 1040, for the calendar" years 1969 (Count I) and 1970 (Count II), "which was verified by a written declaration that it was made under the penalties of perjury and was filed with the Internal Revenue Service, which said income tax return he did not believe to be true and correct as to every material matter in that the said return reported gross income from wages" in certain amounts, "whereas, as he then and there well knew and believed, he received substantial income in addition to that heretofore stated."

On July 14, 1975, trial commenced against petitioner and lasted for 5 days. After deliberating for 9½ hours, the jury returned a verdict on July 18, 1975, finding petitioner guilty as charged in both counts (R. 55, Tr. 783-784).

The government presented 48 witnesses and much documentary evidence. Petitioner testified in his own behalf and had two additional witnesses.

Basically, the evidence showed that petitioner had been engaged in the scrap and auto parts business for a number of years. He also leased tractor-trailer trucks and drivers to other firms under the unincorporated name of City Leasing & Drayage Company.

In 1969 and, to a lesser extent in 1970, petitioner continued to sell scrap and auto parts. He received checks payable either in his individual name or to Ballard Iron & Metal or Ballard Auto Parts. The prosecution offered a number of these checks in evidence under the specific items method of proof. (See list in Govt. Exh. 61.)² A few of these checks were deposited to pe-

² These checks were received in evidence over petitioner's objection that they bore endorsements in several handwritings and there was no proof as to which if any had been signed by petitioner. Many of the checks had been received by petitioner's drivers or other employees.

petitioner's bank account, but many were cashed, mostly at a service station operated by Gilbert Burpo who had died prior to trial. The total of these checks for 1969 was \$15,300.12 and for 1970 was \$3,222.52 (Govt. Exh. 61, Tr. 557, 561). None of these checks was reported on petitioner's tax returns for the years involved.

Until July 18, 1969, petitioner also received checks for his unincorporated City Leasing business. Checks totaling \$11,898.92 were received in evidence (Govt. Exh. 61). According to the bank deposit method of proof (Tr. 544) and from bank statements and deposit records (Govt. Exh. 45) and the testimony of IRS Agent Purk (Tr. 544, 560), as reflected on Govt. Exh. 61, the prosecution contended that \$38,849.00 was received by petitioner during 1969, none of which was reported on his tax return.

There were also some other small items claimed by the prosecution to be unreported income for 1969 and 1970 (Govt. Exh. 61). These included checks designated as commission income of \$330.00 for 1969 (Tr. 557), and rental income of \$850.00 and \$2,550.00 for 1969 and 1970 respectively (Tr. 557-558, 561-562).

On July 18, 1969, petitioner and another organized City Leasing and Drayage, Inc., a Missouri corporation (Govt. Exh. 42, Tr. 178). Petitioner received a salary from the corporation in 1969 and 1970, and in 1970 he also received a salary from another corporation. These salaries of \$10,407.00 and \$20,730.00 were the only income items reported on his 1969 and 1970 individual income tax returns (Govt. Exh. 1 and 2). He did not file a Schedule C—Profit or (Loss) From Business or Profession for either year.

After all of the documentary evidence had been admitted, Revenue Agent Purk was permitted to testify as to his compilations which were summarized on his schedules of unreported

amounts of income (Govt. Exh. 61). He concluded that the total alleged gross income not reported by petitioner for 1969 was \$55,329.12 (Tr. 560-561) and for 1970 was \$5,772.52 (Tr. 562).

On cross-examination, Mr. Purk acknowledged that with reference to the bank deposit method of analyzing the City Leasing account, he calculated on Govt. Exh. 61 only gross receipts, and did not deduct any business expenses so as to determine net income, if any (Tr. 570-571).³ Mr. Purk had access to bank microfilm copies of all City Leasing checks for expenses (Tr. 573-574). Mr. Purk acknowledged that he included all Ballard, Ballard Iron & Metal and Ballard Auto Parts checks, despite the fact that the endorsements were not all in the same handwriting (Tr. 601-607). He also paid no attention to rental payments by petitioner in excess of the rent he collected as reflected on Govt. Exh. 61 (Tr. 607-609).

Petitioner testified that he did not report any income other than salaries received in 1969 and 1970 because he was under the impression that he had sustained a loss from the business activities, the loss being caused by excessive expenses and thefts (Tr. 656-660, 677-678). He did not claim the loss on his tax returns because his books and records had been destroyed in a fire, and he had been advised by his bookkeeper that there was no need to report the loss because he could not substantiate it (Tr. 651-655). With reference to the failure to report the rent receipts, petitioner had evidence of payments of rent by him in excess of the amounts received (Deft. Exh. A, Tr. 633-637, 682).

³ Witnesses who had identified checks issued to City Leasing—see page 4 of Govt. Exh. 61—testified that the checks represented a payment of the total charge for rental of the tractor-trailer and use of the driver, out of which petitioner would have to pay the driver and such operating expenses as gasoline, maintenance, insurance, upkeep, etc. See, for example, the testimony of witnesses Zimmerman of Orscheln Bros. Truck Lines at Tr. 248-249, and Edmiston of Arkansas-Best Freight System at Tr. 363-365.

At the conclusion of the trial, the prosecution's position was that, regardless of whether there was a loss or gain from the business, petitioner was required to file a Schedule C to his Form 1040 because of the sizeable receipts, and that the failure to file the Schedule C constituted a violation of § 7206(1). Petitioner's position was that there was no evidence of any requirement by law, regulation or instructions to a taxpayer that Schedule C had to be filed when his business resulted in a loss which he did not intend to claim, and that petitioner was only required to file his Form 1040 income tax return for each of the years, and they accurately reported W-2 forms and salaries received.

At the close of all the evidence, the Court overruled petitioner's motion for judgment of acquittal (R. 45, Tr. 714). The cause was submitted to the jury after argument (Tr. 727-763) and the Court's charge to the jury (Tr. 763-777), to which petitioner made certain objections (Tr. 714-726, 778). The jury deliberated continuously for 9½ hours, during which they asked a question about the fire which destroyed petitioner's records, which the Court refused to answer (Tr. 780-782), and requested that the instructions be reread, which was done (Tr. 782). The jury returned a verdict finding petitioner guilty on both counts (R. 55, Tr. 783-784).

On August 7, 1975, petitioner was sentenced on each count to a term of imprisonment for three years and a fine of \$2,000.00, the term of imprisonment on each count to run concurrently but the fines to be cumulative for a total of \$4,000.00 (R. 56, Tr. 794).

Petitioner duly filed his notice of appeal to the United States Court of Appeals for the Eighth Circuit (R. 57). On April 28, 1976, a panel of the Court of Appeals filed an opinion (Appendix A) affirming petitioner's conviction as to Count I but reversing and remanding as to Count II. The Court of Appeals decided that the failure of the District Court to give an instruction that

the jury must consider costs of goods sold was not prejudicial as to 1969, but such omission was prejudicial as to 1970 and constituted plain error.

Petitioner filed a petition for rehearing and suggestion of appropriateness of rehearing in banc. The petition was denied on June 2, 1976. (See Appendix C.)

This petition for a writ of certiorari seeks to review the judgment of the Court of Appeals affirming petitioner's conviction on Count I.

REASONS FOR GRANTING THE WRIT

The Court of Appeals found plain error as to Count II in the failure of the District Court to properly define gross income, but no such plain error as to Count I. By its ruling the Court of Appeals rejected petitioner's argument that no submissible case was made for a prosecution under 26 U.S.C. § 7206(1) as to either Count. The opinion below should be reviewed by this Court because it has established some erroneous and dangerous precedents in the administration and enforcement of the federal tax laws.⁴

Both counts of this indictment (R. 1-2) accused petitioner of filing a false income tax return "in that the said return reported gross income from wages (in certain amounts), whereas, as he then and there well knew and believed, he received substantial income in addition to that heretofore stated." The defense to these allegations was that petitioner did not have income other than his reported wages, but instead had a loss for the years in question, and the loss was not reportable because he did not attempt to deduct the loss on his tax return. The issues created by the indictment and the defense, the proof relating to these issues, and the manner in which the District Court and the Court of Appeals have approached and decided these issues

⁴ It is no secret that in recent years the government has drifted away from tax evasion prosecutions under 26 U.S.C. § 7201, where the prosecution is under a heavy burden to prove fraud and an actual tax deficiency. Instead the government is content to prosecute under 26 U.S.C. § 7206(1), the filing of a false return, where the prosecutor's burden is substantially less, in that fraud need not be proved and there does not have to be a tax deficiency. In fact, the defense becomes more difficult, for as the Court of Appeals observed in the opinion below: "The burden rests upon the taxpayer to disclose his receipts and claim his proper deductions." The net result is that the prosecutor has a much lighter task and still may achieve a felony conviction, his only loss being that the defendant can be sentenced to three years imprisonment on each count instead of the five years authorized by § 7201.

have generated the following reasons why this petition for a writ of certiorari should be granted:

1. The government seemed to have two theories in the trial as to the nature of the offense:

A. That gross receipts, irrespective of whether the net result was a loss, should have been reported on Schedule C to Form 1040; that Schedule C was not included with the tax return; therefore the failure to include Schedule C was the offense.

B. That evidence of a business loss was irrelevant, but even if there was a loss, petitioner was required to report the loss on his Form 1040 tax return.

But the prosecution never produced any law, regulation or other authority that Schedule C must be filed even where there is a loss which is not being claimed.

The first witness, Durham, an IRS representative, could find nothing on the return that Schedule C must be filed (Tr. 40). During the cross-examination of IRS Agent Purk, he was asked for the authority requiring the filing of a Schedule C in the event of a loss (Tr. 593). With the Internal Revenue Code in front of him, as well as Form 1040, Schedule C, and published instructions applicable to tax returns, he could point to no written requirement for filing a Schedule C or reporting a loss where the taxpayer does not intend to claim the loss (Tr. 593-601). He finally concluded with the strange opinion, unsupported by any authority,⁵ that the taxpayer must claim his loss and then contribute the tax saving to the government (Tr. 600-601)!

The prosecution totally failed to show any statutory or other authority requiring the filing of a Schedule C under the cir-

⁵ If the "experts" could not find the authority, how could a non-expert like petitioner have the guilty intent required to sustain a tax conviction?

cumstances of this case. The District Court erroneously implied that there was such authority in sustaining an objection to petitioner's closing argument (Tr. 754). The Court of Appeals ignored this issue, although by its opinion it impliedly decided, without citation of authority, that a Schedule C must be filed where a loss occurs and the taxpayer does not desire to claim it.⁶

We respectfully suggest that this is an important issue affecting the administration of the tax laws which should be reviewed and decided by this Court.

2. Even assuming that there was some duty to report a loss even though petitioner had no desire to claim it, then at the most this case would involve a failure to file Schedule C rather than the filing of a false Form 1040. See petitioner's objection in this regard to the Court's instruction (Tr. 721-722). Any prosecution should therefore have been brought under Section 7203 rather than Section 7206(1). Although we feel it was improper to submit the cause to the jury on the felony 7206(1) charge, at the very least the Court should have given, as requested, a lesser included misdemeanor offense instruction under Section 7203 (Tr. 724-725).

3. The indictment alleged that petitioner's returns were false because he received "substantial income" in addition to the wages which he reported. The evidence related only to gross receipts, not income. In approving the conviction under these circumstances, the Court of Appeals cites *Siravo v. United States*, 377 F. 2d 469 (1st Cir. 1967), in two places.⁷

⁶ His lack of desire to claim a loss was a cautiously proper attitude in view of the loss of records and inability to determine and prove the extent of the loss.

⁷ The second reference, to pages 473-474 of 377 F. 2d, is to a portion of the *Siravo* opinion discussing a count of failure to file a return. Where there are receipts in excess of \$600.00, a prima facie case is made under § 7203. But in the instant case, a return was filed; unreported "receipts" do not make a prima facie case of filing a false return by understatement of "income".

We believe that reliance on *Siravo* is misplaced, and that it in fact sustains our position. *Siravo* recognizes a distinction between "gross income" and "gross receipts" (pages 474-475), but the confusion between the two terms did not prejudice the defendant there because he was charged with failure to report "gross receipts". *Siravo* says that "if there was any difference between gross receipts and gross income . . . the latter must be a smaller figure." Proof of gross income would necessarily be proof of gross receipts, as charged in *Siravo*. But the converse is not true, for the simple reason that gross income will not only be a smaller figure than gross receipts, but it may be zero or a negative figure (a loss). Therefore, where, as in the instant case, the charge relates to "income", proof of gross receipts does not necessarily prove income. Proof of gross receipts cannot be sufficient to show an understatement of income unless all other figures relevant to the determination of income, such as expenses, are also considered.

See also *United States v. Morse*, 491 F.2d 149, 157 (1st Cir. 1974), for the discussion of the requirements of a Schedule C to the Form 1040 tax return. The Court there held that it was appropriate to prosecute under § 7206(1) because of failure to include the gross receipts on Schedule C; but there is a significant distinction because in *Morse* the indictment charged a substantial understatement of "gross receipts" (the information which is required on Schedule C), whereas in the instant case the allegations of the indictment were a substantial understatement of "income" (which is to be included on Form 1040). *Here there was no proof of any such income—just proof of gross receipts*. In other words, had petitioner been charged with the failure to include gross receipts on Schedule C, it might have been a case within the doctrine of *Morse*, but the charge was income and there was no proof of any income (as opposed to gross receipts) required to be reported. This distinction was fully explained to the District Court as late as the conference

on instructions, but was ignored (Tr. 720-721).⁸ To permit proof of failure to report gross receipts where the allegations of the indictment were misstatements of income constitutes a fatal variance. See *Stirone v. United States*, 361 U.S. 212 (1960).

Perhaps (but we do not believe so) petitioner was guilty of failure to supply information of "gross receipts" in violation of § 7203. Perhaps (but we do not believe so) petitioner was guilty of filing a false return in violation of § 7206(1) by omitting "gross receipts". But certainly there was no proof that petitioner was guilty of the charge herein—filing a false return in violation of § 7206(1) by omitting "substantial income".

4. The prosecution and the District Court tried this case on the theory that expenses connected with the operation of petitioner's business enterprises were irrelevant. By the use of the bank deposit and specific items method of proof, the prosecution produced evidence of receipts of money by petitioner—but receipts were not equivalent to "income", of which the indictment spoke. No effort was made by the prosecution to account for legitimate business expenses.

When petitioner first attempted to do so, the prosecutor's objection on the ground of relevancy was sustained (Tr. 191). When petitioner thereafter sought to elicit information as to costs and expenses, for the purpose of showing that expenses exceeded receipts and that there was in fact a loss, he was stopped (Tr. 577, 616-617). Every time the subject was discussed, the District Court made clear its agreement with the prosecutor that costs and expenses were irrelevant to the issues in this case (Tr. 507, 534-535, 580-582, 621). The District Court stated: ". . . and if the government is required to do

⁸ In fact, the instructions compounded the confusion by interchanging the words: gross income (Tr. 769, 772, 773), gross receipts (Tr. 771, 772), income (Tr. 771, 772, 774), and complete gross business income (Tr. 773).

that (produce evidence of expenses), why, it's utterly failed, I'm sure." And the prosecutor responded: "Sure, there's no doubt about that" (Tr. 535). Petitioner's objections were overruled at the conference on instructions as to the failure to allow for items deductible from receipts (Tr. 718, 720, 726). When petitioner argued expenses to the jury, he was prevented from doing so (Tr. 745, 746). And the District Court instructed that deductions or expenses should be disregarded (Tr. 772).

Revenue Agent Purk testified that he had examined the checks issued on the City Leasing account and prepared a profit and loss on the operation (Tr. 571), but petitioner was not permitted to explore the items of expense (Tr. 596). Out of the hearing of the jury it was disclosed that Mr. Purk determined a \$12,000 profit (Tr. 578), but had petitioner been permitted to cross-examine on the items of expense, we believe that it would have been shown that numerous expenses incurred by petitioner were not accounted for by Mr. Purk and that if appropriate adjustments had been made, Mr. Purk's own records would have revealed that there was indeed a loss. Certainly such evidence was relevant on the intent issue. Compare *Ping v. United States*, 407 F. 2d 157 (8th Cir. 1969), where the prosecution's summaries of checking accounts analyzed checks for possible business purposes, the charge being a false return under § 7206(1) by understatement of gross income.

We believe that under the circumstances of this case, the prosecution and the District Court misconstrued the requirements of proof by the government. *United States v. Morse*, 491 F. 2d 149 (1st Cir. 1974), involved charges of tax evasion as well as filing false returns under § 7206(1); the government there resorted to the bank deposit method of proof. The First Circuit recognized the requirement that non-income items be deducted in the use of the bank deposit method, and we submit that the *Morse* discussion of non-income items is equally applicable to expense items and costs of doing business in the instant case.

Therefore just as the prosecution in *Morse* was required not only to exclude non-income items but to have competent proof as to the amount thereof, we believe that the prosecution in the instant case was required to exclude legitimate business deductions and to prove the amounts of such deductions.

To show its relevance in the instant case, we can interpolate the paragraph on pages 154-155 of 491 F. 2d in the *Morse* case as follows:

"Plainly stated, in computing the deduction for (business expenses), the agent not only examined the bank deposit records, which were admittedly in evidence before the jury, but examined the (records pertaining to expenses) as well. Knowing the amount of (the receipts and expenses) put the agent in a better position to evaluate the bank deposit records to ascertain the amounts of deposited (receipts as well as allowable expenses). However, in the absence of the (records pertaining to expenses), the jury was at a significant disadvantage should it seek to corroborate the agent's testimony. Thus, without any meaningful documentary corroboration of an important aspect of (Purk's) testimony, it had virtually no choice but to rely exclusively on his hearsay conclusion that (appellant had taxable income rather than a loss). Moreover, without admissible independent documentation, neither the trial court, nor this court is in a position to adequately evaluate the accuracy of the amount of (expenses) available for non-income deductions. In order to eliminate the hearsay aspect of his testimony the government should have introduced all available evidence upon which the agent based his non-income deposit calculations. See *Siravo v. United States*, 377 F. 2d 469, 474 (1st Cir. 1967); *United States v. Doyle*, supra. As we view the record, this would not have presented the government with any serious or substantial burden."

This case presents an important issue as to the requirements for proof of expenses in a prosecution for filing a false income tax return by failing to report "substantial income". We respectfully suggest that this issue should be reviewed by this Court.

5. The Court of Appeals recognized the error of the government's theory of the case; it cited Treasury Regulation § 1.61-3⁹ as authority for limited relevance of some deductible items, to-wit, the costs of goods sold in a merchandising business. But we believe the Court erred in its application of this regulation in two respects: (a) its relevance to the salvage and parts business but not to the leasing business, and (b) the affirmance of the conviction on Count I while reversing as to Count II.

A. In discussing the evidence with reference to 1969, the Court of Appeals seemingly distinguishes between gross receipts from the leasing business and gross receipts from the salvage and parts business. The opinion does not recognize the propriety of deductions from gross receipts of the leasing business, but does as to the salvage business. In so ruling on the authority of Regulation § 1.61-3, the Court of Appeals has made a distinction which is not recognized by the Internal Revenue Service. Thus, Schedule C, line 1, provides for a report of "gross receipts or sales", and line 2 authorizes a deduction for "cost of goods sold and/or operations". In the instructions for preparation of Schedule C, there are separate instructions as to line 2 for a business involving "goods sold" and an operational-type business "Where Inventories Are Not an Income-Determining Factor". Schedule C and the instructions recognize that costs of operations for the leasing business are similar to the cost of goods sold for the parts business. These are the various lines contained in Schedule C-1, such as cost of labor (including

⁹ The Court of Appeals correctly assumed (fn. 5 of its opinion) that Treas. Reg. § 1.61-3 was never called to the attention of the District Court.

drivers), materials and supplies, and other costs of operation (including such items as gas and oil, maintenance, insurance, etc.)—compare footnote 2 of opinion.

B. The Court of Appeals reversed the conviction on Count II for the reason that the failure to instruct as to deduction of costs of goods sold was plain error and prejudicial as to the year 1970. But with the same types of transactions in 1969, the failure to give the same instruction was held to be not prejudicial. We suggest, first of all, that these grossly inconsistent applications of the plain error doctrine require review by this Court. Secondly, we believe that the Court of Appeals completely overlooked the intractable position taken by the District Court as to the relevance of deductions. It is true, as pointed out by the Court of Appeals, that petitioner "did not request such an instruction" under Treas. Reg. § 1.61-3 that in a merchandising business gross income means gross receipts less costs of goods sold; but a request was not justified because there was no evidence in the case to support it—through no fault of petitioner. As previously indicated, the government produced no evidence of costs of goods sold, and when petitioner sought to do so, he was always thwarted. An instruction actually given was the opposite of what the Court of Appeals said should have been given, for the District Court charged (Tr. 772):

"Furthermore, the receipt of such gross income must be disclosed without regard to deductions or expenses which that individual may be entitled to claim as offsets against that gross income."

Thus this case was tried by the government and the District Court on the theory that deductible expenses were irrelevant to the issues. Because of the District Court's rulings, there was no evidence to warrant a request for an instruction as suggested by the Court of Appeals, and it is obvious that had it been re-

quested, the District Court would not have given it. Such a request would have been a useless act.

* * * * *

This petition not only presents issues on which the opinion below is in conflict with decisions of the First Circuit (*Siravo* and *Morse*) and of this Court (*Stirone*), but it also provides an opportunity to clarify and settle important questions relating to the administration of the revenue laws. Decision by this Court of these issues would be of great assistance in the preparation of tax returns and would also establish guidelines for the trial of cases which account for a substantial portion of the dockets of District Courts.

CONCLUSION

For these reasons it is respectfully submitted that this petition for writ of certiorari should be granted.

IRL B. BARIS

KENNETH H. GRAEBER
721 Olive Street
St. Louis, Missouri 63101
Attorneys for Petitioner

APPENDIX

APPENDIX A

United States Court of Appeals
For the Eighth Circuit

No. 75-1682

United States of America,

v.

Jack Ballard,

Appellee,

Appellant.

} Appeal from the
United States Dis-
trict Court for the
Eastern District of
Missouri.

Submitted: February 12, 1976.

Filed: April 28, 1976.

Before Bright, Stephenson, and Henley, Circuit Judges.

Bright, Circuit Judge.

A two-count indictment charged appellant Jack Ballard with willfully making and subscribing false income tax returns for calendar years 1969 (count I) and 1970 (count II), in violation of § 7206(1) of the Internal Revenue Code of 1954, 26 U.S.C. § 7206(1).¹ Count I of the indictment alleged that for 1969,

¹ That section, as applicable, reads:

Any person who—

(1) Declaration under penalties of perjury.

Willfully makes and subscribes any return, statement, or other document, which contains or is verified by a writ-

Ballard reported gross income from wages in the amount of \$10,407, even though he “* * * knew and believed, he [had] received *substantial income* in addition to that heretofore stated.” Count II alleged that Ballard’s return for 1970 reported a gross income from wages in the amount of \$20,730, whereas Ballard “knew and believed, he [had] received *substantial income* in addition to that [amount].” (Emphasis added).

The jury convicted Ballard on both counts and the district court thereafter sentenced Ballard to three years’ imprisonment on each count with the sentences to be served concurrently, plus a fine of \$2,000 on each count.

Ballard appeals contending (1) that the grand jury proceedings were invalid; (2) that the Government failed to make a submissible case for the jury and that a fatal variance existed between the allegations of the indictment which asserted that Ballard had received “substantial income” in addition to his reported wages each year and the Government’s proof which disclosed that Ballard had failed to report certain *gross receipts* from his businesses; (3) that the trial court erred in its application of the Jencks Act (18 U.S.C. § 3500), by denying appellant’s counsel access to certain records in the case until late in the trial; (4) that the trial court erred in receiving numerous checks into evidence as exhibits without proof of appellant’s endorsement thereon; and (5) that the trial court erred in declining to answer a question submitted by the jury during its deliberations.

We have carefully reviewed the record and conclude that the conviction on count I should be affirmed, but that count II should be reversed for a new trial. Although the trial lasted

ten declaration that it is made under the penalties of perjury, and which he does not believe to be true and correct as to every material matter; * * * shall be guilty of a felony * * *.

for five full days, the crucial evidence bearing on this appeal can be summarized with relative brevity.

During the tax years in question, Ballard engaged in two distinct business ventures. In 1969, and, to a lesser extent in 1970, the taxpayer operated a scrap metal and motor vehicle parts business known as Ballard Auto Parts and Ballard Iron & Metal Company. He had engaged in this business for a number of years but phased it out in 1970.

In Ballard’s second venture, City Leasing & Drayage Company, he operated a tractor-trailer rental business, leasing tractors and trailers and furnishing drivers to various truck lines that operated generally on a long-haul basis. This business became incorporated on July 18, 1969, and its operations after that date did not enter into the computation of Ballard’s alleged understatement of income.

In each of the years in question, Ballard filed an individual income tax return on Form 1040 without attaching any Schedule C—Profit or (Loss) From Business or Profession. In his 1969 return, Ballard disclosed as income only wages received from City Leasing & Drayage Co., Inc. in the sum of \$10,407. In 1970, he disclosed wages totaling \$20,730, from City Leasing & Drayage Co., Inc. and from a second employer, Metropolitan Towing Co. He supported these amounts by employers’ wage and tax (withholding) statements.

For the year 1969, the Government introduced evidence that Ballard Auto Parts and Ballard Iron & Metal Co. had received checks from customers for motor vehicle parts, salvage, and the like in the sum of \$15,300, commission income of \$330, and rental income of \$850. The Government proved these amounts by calling as witnesses customers of Ballard who had issued checks to Ballard Auto Parts and Ballard Iron & Metal in amounts which totaled the figures noted above and which the Government tabulated into a summary of alleged gross income

of Jack Ballard doing business as Ballard Auto Parts and Ballard Iron & Metal for calendar year 1969.

In its investigation of City Leasing & Drayage Co. to July 18, 1969, the Government discovered deposits of nearly \$46,000 in checks to a bank account at the Northwestern Bank & Trust Company. In checking these deposits, the Government attributed about \$7,000 to non-income items and attributed the balance of almost \$39,000 as gross receipts of the business of City Leasing & Drayage Co. Ballard reported none of these receipts on his 1969 income tax return. The Government further verified the receipt of about \$12,000 of this latter amount by calling customers of Ballard as witnesses. They testified to issuing checks to Ballard doing business as City Leasing & Drayage. See n.2 *infra*.

For the year 1970, the Government's summarization disclosed that Ballard Auto Parts and Ballard Iron & Metal had received \$3,222.52 for sales of salvage and motor vehicle parts to customers and \$2,550 in rental income from third parties for a total "Alleged Gross Income Not Reported" of \$5,772.52.

Ballard testified on his own behalf and stated that fires had destroyed his business records and that he had in fact sustained a loss in his businesses during each of the two years in question. He stated he had told Mrs. Dorothy Benigno, a bookkeeper who had prepared his tax returns, that his records had been burned and that he had sustained losses in his businesses for those two years. Ballard quoted Mrs. Benigno as stating that if he could not produce records showing a loss, there was no point in claiming a loss on his tax returns.

With regard to the operation of his salvage and parts business, Ballard, in essence, admitted cashing approximately \$11,000 of the checks produced by the Government and stated that he needed the cash in the operation of his business. He said that he paid cash for used cars and converted these cars to

scrap after salvaging useable parts and testified that he spent all cash receipts in operating this business. With respect to the leasing company, Ballard testified generally that his expenses exceeded his gross receipts.²

The principal issue on this appeal focuses upon appellant's contentions that he sustained a business loss for the years in question and that the Government could not establish its case by mere proof of gross receipts but was required to demonstrate Ballard's receipt of income, measured by gross receipts less expenses. To prove the violation, the prosecution contends that it need only show a willful failure to report gross receipts from a trade or business.

In *Siravo v. United States* 377 F.2d 469 (1st Cir. 1967), the indictment charged taxpayer with violations of §7206(1), and with failure to file a tax return under §7203. The indictment was phrased in terms of willfully failing to disclose "substantial gross receipts from a business activity * * *." (Emphasis added). The proof established that the taxpayer operated as a subcontractor assembling jewelry components for various manufacturers and that he failed to disclose any gross receipts from that business in his tax returns for several years. No evidence surfaced as to the amount of any costs or expenses sustained by the taxpayer. In affirming the conviction, the court said that a tax return that "omits material items necessary to the computation of income is not 'true and correct' within the meaning of section 7206." *Id.* at 472.

This circuit has addressed analogous issues in *United States v. Lodwick*, 410 F.2d 1202 (8th Cir.), *cert. denied*, 396 U.S.

² Witnesses who had identified checks issued to City Leasing & Drayage Co. testified that the checks represented a payment of the total charge for rental of the tractor-trailer and use of the driver, out of which appellant would have to pay the driver and such operating expenses as gasoline, maintenance, insurance, upkeep, and other items.

641 (1969), and *United States v. Engle*, 458 F.2d 1017 (8th Cir. 1972). Taxpayers were both charged with §7206(1) violations and in both cases we made clear that under §7206(1), the Government did not need to establish an actual tax deficiency in a §7206(1) prosecution. The burden rests upon the taxpayer to disclose his receipts and claim his proper deductions. In both *Engle* and *Lodwick*, taxpayers received moneys that clearly were income. See also *United States v. Romanow*, 509 F.2d 26 (1st Cir. 1975); *United States v. DiVarco*, 484 F.2d 670 (7th Cir. 1973); *United States v. Jernigan*, 411 F.2d 471 (5th Cir. 1969).

In this indictment, the Government alleged that Ballard received "substantial income" in addition to the amounts which he disclosed on his tax returns. The Government here contends that all gross receipts represent income which must be reported.

But gross receipts may or may not represent income, depending on the circumstances. As the late Circuit Judge Johnsen observed in *Clark v. United States*, 211 F.2d 100 (8th Cir. 1954):

Of course, gross income and not gross receipts is the foundation of income-tax liability, for it is only earnings, profits and gains which the statute subjects to tax. And manifestly, gross receipts cannot be called gross income insofar as they consist of borrowings of capital, returns of capital, or any of the other items which * * * the Internal Revenue Code * * * has excluded from gross income. But when all of these things have duly been taken into account, no matter by what process it has been done, the amounts remaining of Gross Receipts necessarily may, in its character as a result, properly reflect taxpayer's Gross Income, which it is his duty to report. [*Id.* at 102.]

In the early tax case of *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179 (1918), the Court said:

Whatever difficulty there may be about a precise and scientific definition of "income," it imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities. As was said in *Stratton's Independence v. Howbert*, 231 U.S. 399, 415: "Income may be defined as the gain derived from capital, from labor, or from both combined."

Understanding the term in this natural and obvious sense, it cannot be said that a conversion of capital assets invariably produces income. If sold at less than cost, it produces rather loss or outgo. Nevertheless, in many if not in most cases there results a gain that properly may be accounted as a part of the "gross income" received "from all sources"; and by applying to this the authorized deductions we arrive at "net income." In order to determine whether there has been gain or loss, and the amount of the gain, if any, we must withdraw from the gross proceeds an amount sufficient to restore the capital value that existed at the commencement of the period under consideration. [*Id.* at 185.]

The general term "income" is not defined in the Internal Revenue Code. Section 61 of the Code, 26 U.S.C. § 61, defines "gross income" to mean

all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;

(2) Gross income derived from business;

* * *

(5) Rents[.]

* * *

Treasury Regulation § 1.61-3 (1976) explains "Gross income derived from business" and reads in part:

(a) In general. In a manufacturing, merchandising, or mining business, "gross income" means the total sales, less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources.

Applying these definitions to the respective contentions made by the parties, it appears that the Government makes too broad a claim in asserting that gross receipts invariably measure income or gross income. Conversely, the appellant's argument that all business expenses must be deducted from gross receipts to measure income or gross income defines income too narrowly.

In count I (1969), Ballard's gross receipts from his leasing operations of trucks and truck-trailers (City Leasing & Drayage Company) amounted to almost \$39,000, and commissions and rentals received incident to his scrap business amounted to \$1,180. These receipts clearly constituted items of gross income which Ballard was required to report pursuant to § 61 of the Code. However, the approximately \$15,000 which Ballard received from the sales of salvage and motor vehicle parts did not entirely represent gross income for in the merchandising of scrap and motor vehicle parts, Ballard's gross income excluded the cost of goods sold. Treas. Reg. § 1.61-3. However, since Ballard could not produce records of his salvage and parts business for 1969 and 1970, the Government had no means of showing Ballard's cost of goods for those years.³

Gross receipts necessarily represent a starting point in ascertaining gross income. Although some of Ballard's gross receipts

³ The 1968 closing inventory as reflected by the Schedule C attached to Ballard's 1968 income tax return showed a small inventory of approximately \$2,000, which presumably was carried over to 1969 and could be deducted from the gross receipts of the salvage and parts business in ascertaining gross income or gross profit from that business in 1969.

from his parts and salvage business for the year 1969 may not have been gross income, as we have already observed, Ballard received about \$39,000 in gross receipts from his leasing business and over \$1,000 as commissions and rental income—all of which clearly constituted gross income and should have been reported. Additionally, the documentation provided by Ballard's tax returns for the two years prior to 1969 strongly implied that a substantial part of the receipts from the salvage and parts operations for 1969 represented gross income.⁴

The Government's burden here is less than in a tax evasion case. In the latter, the prosecution must show taxpayer's receipt of taxable income. *United States v. Romanow*, 509 F.2d 26, 28 (1st Cir. 1975); *United States v. DiVarco*, 484 F.2d 670 (7th Cir. 1973); *United States v. Jernigan*, 411 F.2d 471, 473 (5th Cir. 1969). The prosecution's burden here is similar to that in a failure to file case in which evidence of unexplained receipts shifts to the taxpayer the burden of coming forward with the amount of offsetting expenses. *See Siravo v. United States*, *supra*, 377 F.2d at 473-74. Thus, the evidence of unexplained receipts here established a prima facie case of taxpayer's failure to disclose substantial amounts of gross income.

Our examination of the record discloses that the district court did not instruct the jury that in a merchandising business gross income means gross receipts less costs of goods sold.⁵ The taxpayer did not request such an instruction and its absence caused

⁴ Ballard's 1967 and 1968 tax returns, which were admitted into evidence show the following: In 1967, Ballard Iron & Metal had gross sales of almost \$79,000, less cost of goods sold of about \$53,000, for a gross income or gross profit of about \$26,000. In 1968, Ballard Iron & Metal made gross sales of over \$41,000 but the cost of goods sold amounted to \$27,000, resulting in gross income (or gross profit) of about \$14,000.

⁵ The Government failed to cite Treas. Reg. § 1.61-3 to this court. We must assume that it also failed to call this regulation to the attention of the district court.

no prejudice to the appellant as to count I (1969 return) since the evidence disclosed substantial omissions in the reporting of taxpayer's gross income from non-merchandising and merchandising businesses.

We are, however, concerned about the conviction on count II for there the Government relied on sales receipts of the salvage and parts business in the sum of approximately \$3,000, plus rental income of approximately \$2,500, to show omission of gross income and to prove a willful failure to report "substantial income" in addition to wages.

Ballard in 1970, sought to liquidate his salvage yard operation. Testimony established that at least one sale of salvage in the sum of \$500 represented a bulk sale of inventory. Although Ballard could not document his opening inventory for the year 1970, nor other costs of the goods sold, the fact that Ballard was liquidating his scrapyard suggests that a substantial part of the gross receipts from that sale of salvage and parts probably represented Ballard's carry-over inventory. Moreover, the appellant offered evidence that he had received the rental income from individuals who were apparently sublessees and that he incurred substantial offsetting expenses in paying his own landlord.

The jury deliberated about nine and one-half hours and requested and received a rereading of the instructions. The Government presented a substantially weaker case to support the 1970 violation (count II) as compared to the 1969 violation (count I). Thus, the absence of an instruction defining gross income under Treas. Reg. § 1.61-3, as it relates to the merchandising business may have prejudiced appellant materially.⁶

⁶ Otherwise, the court appropriately defined gross income as
* * * all income from whatever source derived, including, but not limited to the following items:

1. Gross income derived from business
2. Rents
3. Compensation for services, including fees, commissions, and similar items.

Under the circumstances related here, the interests of justice require that we consider the omission of the special definition of gross income as it applies to the merchandising business as constituting plain error. Thus we vacate the conviction on count II and remand for a new trial on that count should the Government be interested in further prosecution.⁷

II. Other Issues.

The appellant contends that the district court erred in not permitting his counsel to cross-examine Internal Revenue Agent Henry Purk concerning expenses incurred in the truck leasing business after Purk had testified on direct examination that he had ascertained gross receipts from an examination of taxpayer's bank records relating to City Leasing & Drayage Company and that the account also disclosed some expenses of Ballard's operations.

In sustaining the Government's objections to the questions as irrelevant, the court recognized that proof of expenses bore upon the issue of willfulness since the appellant claimed that he sustained a loss and did not realize that he was required to report gross income items if he did not intend to claim a loss. However, the court ruled, in essence, that appellant's counsel could call Agent Purk as his own witness during the appellant's case, treating Purk as a hostile witness rather than pursue the matter on cross-examination. According to the record made outside the jury's presence, Agent Purk would have testified that after deducting expenses as shown by the bank account, the operations of City Leasing & Drayage produced a profit of approximately \$12,000. Appellant's counsel did not choose to call Agent Purk for additional testimony.

⁷ This reversal affects only the taxpayer's total fine as the sentence otherwise runs concurrently on counts I and II.

Although the court very well might have permitted appellant's counsel to cross-examine Purk on the expense issue during the prosecution's case as related to the issue of taxpayer's willful intent, the district court's exercise of its discretion to the contrary in the context of this case did not amount to prejudicial error. The court's ruling fell within its broad discretion in regulating the order of presenting evidence at the trial. See *United States v. Webb*, No. 75-1791 (8th Cir., Apr. . ., 1976).

The appellant also objects to the receipt in evidence of certain checks which did not bear the genuine endorsement of Ballard or his wife. The evidence established, however, that the checks in question were made payable to Ballard or to his business. Others may have endorsed Ballard's name on these particular checks. Those checks represented only a relatively small portion of the receipts of Ballard's salvage and parts operation. Ballard admitted that either he or his wife signed and cashed checks representing about \$11,000 of the approximately \$15,000 received in the salvage business. We see no clear error here and in any event, if any error existed, the appellant suffered no prejudice through this ruling.

Ballard also claims the court erred in refusing to respond to questions asked by the jury during its deliberations.* The trial court answered the first question upon agreement of the parties but in its discretion properly declined to search the transcript to obtain a specific answer to the second question. The court advised the jury to answer the second question from its collective recollection of the evidence. The district court committed no error in this ruling.

We have also examined other contentions raised by the appellant. They are without substantial merit.

* The jury asked two questions. The first, "(1) May we have the dates of the fires?" was answered by the court. The second question and the one which the court declined to answer read: "(2) When did he [Ballard] say he knew the records were destroyed?"

Accordingly, we affirm on count I, and for reasons heretofore stated, reverse and remand on count II.

A true copy.

Attest:

Clerk, U.S. Court of Appeals, Eighth Circuit.

APPENDIX B

Judgment

United States Court of Appeals
For the Eighth Circuit

No. 75-1682

September Term 1975

The United States,		
vs.	Appellee,	} Appeal from the United States District Court for the Eastern District of Missouri.
Jack Ballard,	Appellant.	

This cause came on to be heard on the original designated record of the United States District Court for the Eastern District of Missouri and briefs of the respective parties and was argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court that Count I of the judgment of the said District Court be and is hereby affirmed.

And it is further ordered by this Court that Count II of the judgment of the said District Court be and is hereby reversed and is remanded on Count II of the said District Court for proceedings in accordance with this opinion.

April 28, 1976

APPENDIX C

United States Court of Appeals
For the Eighth Circuit

No. 75-1682

September Term 1975

The United States,		
vs.	Appellee,	} Appeal from the United States District Court for the Eastern District of Missouri.
Jack Ballard,	Appellant.	

The Court having considered petition for rehearing en banc filed by counsel for appellant and, being fully advised in the premises, it is ordered that the petition for rehearing en banc be, and it is hereby, denied.

Considering the petition for rehearing en banc as a petition for rehearing, it is ordered that the petition for rehearing also be, and it is hereby, denied.

June 2, 1976